Nos. 60, 61, 62, 80, 97, 111, 143, 144, and 231

IN THE

Supreme Court of the United States

October Term, 1967

Federal Power Commission, *Petitioner*,
v.
Sunray DX Oil Company, et al.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURTS OF APPEALS FOR THE DISTRICT OF COLUMBIA AND TENTH CIRCUITS

REPLY BRIEF FOR CONSUMER-DISTRIBUTOR GROUP
The Brooklyn Union Gas Company, Long Island Lighting Company, Philadelphia Electric Company, and Public Service Commission of the State of New York, Petitioners in No. 62, Respondents in Nos. 111, 143, 144, and 231

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I. THE NEED ISSUE

In its *Hawkins* and *Sinclair* orders here under review, the Commission reached the ultimate conclusion that the sales of gas proposed by the producer applicants were required by the public convenience and necessity (34 FPC at 905-06, III R. 7301; 34 FPC at

941, IV R. 4188), but because there was no evidence of record to demonstrate that the consuming public had any need for the gas, the Court of Appeals for the District of Columbia Circuit reversed. In its brief to this Court, the Commission, while not denying the absence of any evidence showing a public need for the gas, defends its action essentially on the ground that the Commission has an opportunity to determine the public need for producer sales in other proceedings (FPC Br. 50-55). Additionally, the Commission suggests that there is something in "the nature of the gas business" that causes a pipeline with a present oversupply to obligate itself to take or pay for additional gas which it cannot presently use (Br. 55). Finally, the Commission echoes the view recently expressed by the Fifth Circuit in the related *Turnbull & Zoch* appeal,[1] but expressly disavowed by the Commission in opposing our pending petition for certiorari from the Fifth Circuit's holding,[2] that the District of Columbia Circuit's ruling would cause administrative difficulties through "duplication of effort and multiplication of parties" (FPC Br. 56).

A. Consideration of Need in Other Proceedings

Commission counsel states that the pipelines' need for gas may be considered by the Commission in two different types of pipeline proceedings (Br. 52-53). The "primary method" is a pipeline's application for authority to expand its system to undertake new sales; "another method" is the so-called budget authority to construct facilities to receive additional purchases.

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[1] *Continental Oil Co.* v. *F.P.C.*, 378 F. 2d 510 at 526, *cert. pending*, Nos. 504 *et al.*, this Term.

[2] Memorandum for FPC, *Austral Oil Co. et al.* v. *F.P.C.*, Nos. 504, 520 and 526, this Term, pp. 5-6.

Accordingly, says Commission counsel (Br. 51), a producer cannot begin the sale of gas in interstate commerce "unless the Commission has at some point authorized the construction of facilities that the pipeline company requires to receive the gas."[3] Commission counsel's reasoning, however, is faulty. In the pipeline expansion case—which, unlike the budget authority, is frequently the subject of contested hearings—the public-need issue is whether there is a public need for the pipeline sale and facilities there proposed, not whether there is a public need for the reserves which the pipeline has attached as a result of a prior producer certificate case; and the sole question relating to supply is whether the reserves are *adequate* to make the proposed sale feasible, not whether they are *excessive*. Indeed, the fact that a pipeline has a financially burdensome oversupply is regarded by the Commission as a factor tending to justify an otherwise questionable sale.[4] The budget-type authority provides even less of a check on pipeline supply; the whole purpose of the Commission's Regulation governing budget-type authority is to permit the Commission to grant advance authorization for undesignated and unspecified minor construction projects *without*

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[3] Although Commission counsel charges the court below with having "overlooked" this "crucial consideration" (Br. 51), one reason the court may have "overlooked" it is that counsel failed to make this point below. Moreover, the statement is incorrect; where, for example, increased deliveries to the pipeline are to be made at an existing delivery point, no additional pipeline authority is required.

[4] See, e.g., *United Gas Pipe Line Co.*, 34 FPC 1063 (1965); *Midwestern Gas Transmission Co.*, 32 FPC 1087 at 1096 (1964); *Florida Gas Transmission Co.*, 29 FPC 1243 (1963); *Trunkline Gas Co.*, 27 FPC 178 (1962), 30 FPC 829 (1963), 32 FPC 1220 (1964).

hearing or investigation, and even the Commission itself has, on occasion, expressed surprise and indignation when the pipelines have used the minor facilities thus blindly authorized as a cover for the attachment of major reserves, see, *e.g.; Tennessee Gas Transmission Co.,* Op. 413, 30 FPC 1477 (1963), *aff'd, Tennessee Gas Transmission Co.* v. *F.P.C.,* 340 F. 2d 100 (10th Cir. 1964), *cert. denied,* 381 U.S. 950 (1965).

Thus, while it is theoretically true that a review of the pipeline's need for additional gas *could* be made in the pipeline proceedings, the hard fact is that no such review is made, with the result that the pipelines have been encouraged to enter the market and bid in a wasteful and preemptive manner for additional gas supplies, without regard to whether those supplies are actually needed.[5] And although Commission counsel asserts (Br. 55) that

> "the Commission procedure differs from the prescription of the District of Columbia Circuit only in that the agency characteristically makes its primary determination of need in pipeline rather than in producer proceedings,"

the fact is that neither in the record below *nor in any other record* has the Commission determined that the purchasing pipelines need the gas involved here in order to supply their markets or that their markets could not be supplied without this gas. If indeed the Commission had made such a finding in other proceedings, it would have been a simple matter to receive the relevant data in evidence in this proceeding by refer-

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[5] The producers are naturally enthusiastic about such preemptive bidding, which artificially enlarges demand and tends to drive up prices; see Brief for Shell Oil Company *et al.*, p. 58: "The pipeline must purchase the gas immediately or lose the entire reserve . . . ."

ence to the record in the other proceedings,[6] but no such offer of evidence was made, nor indeed was any finding in any other specific proceeding mentioned by the Commission in its orders here under review. Eight years ago this Court remarked, *Atlantic Refining Co. v. Public Service Commission of New York (Catco),* 360 U.S. 378 at 393:

> "Nor do we find any support whatever in the record for the conclusory finding on which the order was based that 'the public served through the Tennessee Gas system is greatly in need of increased supplies of natural gas.' 17 F.P.C. 880, 881. Admittedly any such need was wrapped up in the Commission's action in Docket G-11107, where Tennessee was asking for permission to enlarge its facilities. However, the two dockets were not consolidated and the Presiding Examiner conditioned his approval here on the granting of the application in Docket G-11107, no part of which record is here."

A further major defect in the Commission's suggested procedure that need can and should be considered in pipeline proceedings is that where the pipeline hearing is held subsequent to the Commission's certification of the producer sale, the Commission is likely to feel impelled to find need in order to justify its prior producer certification.[6a] The experience in the one and only case where the Commission actually examined a

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[6] Receipt of evidence by reference to the record in another proceeding is expressly provided for by the Commission's Rules of Practice and Procedure, § 1.26(c)(3), 18 CFR § 1.26(c)(3), and the practice is exceedingly common in FPC proceedings.

[6a] Even if the pipeline hearing were held *before* the producer permanent certificate had issued, the Commission would feel similarly impelled, for it is the Commission's practice to grant the producer temporary certification almost immediately upon the filing of the producer application.

pipeline's need for the gas involved in these proceedings is instructive.[7] Among the 41 sales certificated by the Commission's *Sinclair* opinion here were 17 sales to Lone Star Gathering Company, a newly formed company which proposed to gather the gas for processing and resale to United Gas Pipe Line Company. The Lone Star-United applications were set down for hearing shortly after issuance of the *Sinclair* opinion in September 1965, and although the evidence of United's need for the gas was slight, the Commission held that need had been shown,[8] *Lone Star Gas Co.,* Opinion

[7] The Commission brief (p. 55) states that the New York Commission "participated in two pipeline cases growing out of the producer applications in issue here." One of these is the Lone Star-United case discussed in this section of our brief. The other, *Coastal Transmission Corp.,* G-18338, resulted in the issuance of a permanent certificate in August 1961, 26 FPC 318, after the New York Commission had been excluded, 23 FPC 752, and prior to the time that the Commission, following judicial reversal of its exclusion of New York, entered an order permitting New York to intervene, 26 FPC 531. In any event, the Commission did not find in its order that the pipeline required the producer sales in order to serve its market, and indeed in a subsequent order, 26 FPC 677 at 684, the Commission expressly found that "Coastal can render the service it proposes without the reserves" involved in some 16 of the producer dockets. Moreover, as noted in our initial brief (pp. 23-24), the fact that pipelines were in a serious and costly oversupply situation had not yet come to light at the time of the 1961 *Coastal* opinion. By 1963, however, the Commission itself took note of the fact that Florida Gas Transmission Company (the successor to Coastal) was in a take-or-pay situation, 29 FPC 1243; and that situation has apparently continued to the present day, *Florida Gas Transmission Co.,* 32 Fed. Reg. 14412 (1967).

[8] In a separate opinion, Commissioner Ross pointed out that the Commission's holding was "nothing more than the unhappy product of the majority's failure to consider public need in passing on producer certificate applications in *Sinclair,*" 36 FPC at 507. He also noted that in many, perhaps most, cases, "unless the Commission considers the question of public need in connection with a producer application, it will never consider the question," 36 FPC at 509.

505, 36 FPC 497 (1966). However, when the New York Commission, on application for rehearing, pointed out the numerous factual and legal errors underlying Opinion No. 505, the Commission unanimously reversed itself, and remanded the case to the Examiner for further hearings at which United might present evidence of its need for the gas. Rather than availing itself of the opportunity to present evidence, however, United finally conceded that it really had no need, withdrew its application, and abandoned the sale which had commenced some four years earlier under temporary certificates, *Lone Star Gas Co.,* 38 FPC ——, Order Vacating Certificates (Sept. 15, 1967). In its brief to this Court, the Commission asserts (Br. 54) that the certificates were vacated "not because of a lack of need, but because the producers' reserves proved inadequate." It is true that, as the result of an alleged decline in reserves—a decline, incidentally, which was not discovered by the producers until after the Commission had issued both its *Sinclair* and *Lone Star* opinions, after the New York Commission had applied for rehearing of the *Lone Star* opinion, and after the Commission had granted rehearing—deliveries declined from slightly in excess of the 40,000 Mcf per day which had been certificated by Opinion No. 505 and had actually been delivered in 1964 to approximately 33,000 Mcf per day in 1966. But it is difficult to understand, other than as a face-saving device to explain the complete reversal of Opinion No. 505, why if United had a continuing and long-term need for 40,000 Mcf per day, it would voluntarily forego a purchase satisfying the bulk (33,000 Mcf a day) of that need.

The fact that the one pipeline purchaser that *was* asked to prove its need for gas involved in the *Hawkins*

and *Sinclair* dockets was unable to do so, plus the fact that four of the five pipelines purchasing this gas have found themselves in take-or-pay situations sufficiently severe to require the Commission to authorize them to undertake new sales (frequently at prices below their own cost) to relieve the excess supply,[9] plus the fact that the Commission has allowed at least one of the pipeline purchasers to include in its rate base some $22 million for gas paid for but not taken[10] indicate rather clearly that the Commission is failing to afford the consumer adequate protection from excess costs attributable to unneeded gas supplies and that the appropriate time for the Commission to provide such protection is, as the framers of Section 7(c) contemplated and as the court below held, *before* the Commission authorizes the producers to introduce their gas in interstate commerce.

B. Prepayments and "The Nature of the Gas Business"

The Commission's statement that there is something about "the nature of the gas business" which causes pipelines to contract for more gas than they can physically put through their systems is not only "broad and unsupported" (373 F. 2d at 823; IV R. 4300) but is, in our view, factually erroneous. There is certainly nothing inherent in the natural gas business or in purchasing under long-term supply contracts which necessitates payments for gas not taken. Among gas distribution companies—which, like pipelines, purchase under long-term contracts with minimum-take provisions—take-or-pay situations are almost non-existent,

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[9] See note 4, *supra*.

[10] *United Gas Pipe Line Co.*, Op. 428, 31 FPC 1180 at 1186-87, 1191-92 (1964); *United Gas Pipe Line Co.*, 32 FPC 1515 at 1519 (1964).

and even among the pipelines themselves take-or-pay situations of the degree involved here were largely unknown until the 1960's. Indeed, as late as December 1962, the Commission unanimously held that a pipeline that was required to pay for gas not taken pursuant to a take-or-pay provision would not be permitted to pass such costs on to its customers in the form of higher rates, *Texas Eastern Transmission Corp.,* Op. 372, 28 FPC 1035 at 1038. Despite the magnitude of the problem—the Commission's 1965 Annual Report notes that six pipeline companies for whom the take-or-pay problem "was particularly acute" had paid $64,097,456 for gas not taken as of the end of 1964, and the 1966 Annual Report indicates that the prepayment balance increased by over 20% during 1965 to a total of $83,228,800 for thirteen pipelines, FPC, 1965 Annual Report, p. 120; 1966 Annual Report, p. 125—the Commission has never conducted an investigation to determine why some pipelines are in an "acute" take-or-pay situation, whereas others are only in a mild take-or-pay situation, and others have no prepaid balances at all. Instead, as here, the Commission simply continues to authorize new sales to pipelines that may never be able to use the gas.

C. The Administrative Difficulty Argument

The Commission's apparent adoption of the Fifth Circuit's "administrative difficulty" argument has, perhaps, been best answered by the Commission itself in its memorandum filed this Term, in Nos. 504 *et al.,* in opposition to our request for certiorari of the Fifth Circuit's holding. The Commission there stated (pp. 5-6):

> "[T]he District of Columbia Circuit's decision . . . would not impose any significant administrative burden on the Commission . . . ."

D. The Producer Contentions

The foregoing response to the Commission's brief largely disposes of the arguments presented on the need issue by the *Hawkins-Sinclair* producers (Brief for Shell Oil Company *et al.*, pp. 53-66). Four points raised by the producers require additional comment, however:

1. The producers assert (Br. 61) that the Commission's rulemaking Order No. 334, issued January 18, 1967,

> "amply protects the pipeline industry from the incurrence of substantial prepayment balances and from possible forfeiture or loss of the payments through inability to take the gas."

The producers are completely wrong with respect to the incurrence of prepayment balances. Although the rule originally contemplated by the Commission, Notice of Proposed Rulemaking, 26 Fed. Reg. 4615 (1961), would have exercised control over the minimum-take provisions that a producer might place in its sales contract—and it is the minimum-take provisions which cause the incurrence of a prepayment balance—the final Commission order adopted six years later yielded to producer pressures and deleted entirely the provision governing minimum-take provisions; the sole change effected by the rule as ultimately adopted was to require a make-up period of not less than five years for whatever prepayments are incurred. During the five-year period, however, the pipeline will presumably be permitted to include the amount of the prepayments in its rate base.

2. The producers state (Br. 62-63) that in *Hawkins* they "did adduce evidence which demonstrates that the sales involved in these proceedings did not require the

pipeline purchasers to pay for gas which they could never take." The producers' statement requires supplementation. The *Hawkins* producers presented no evidence whatever as part of their direct case on this issue. On cross-examination by Commission staff counsel (who on this issue was aligned with the producers), the producer witness testified that at least two pipelines purchasing in the Texas Gulf Coast had incurred "substantial prepayments for gas not taken" (III R. 971-72). On redirect three days later, the witness testified that she had examined the 1963 annual reports filed with the Commission by the four pipeline purchasers in *Hawkins,* and that two of the four showed no outstanding balance for gas not taken (III R. 1338-39). On recross-examination, however, the witness admitted (III R. 1360-61) that a pipeline can have serious take-or-pay problems long before it actually is forced to pay for gas not taken, *e.g.,* to avoid paying for gas not taken under newer, higher-priced contracts, the pipeline will cut back its takes under older, lower-priced contracts.

3. The producers suggest that the holding of the court below requiring proof of need before a certificate may issue constitutes a "novel theory" (Br. 64). While we think that ordinarily novelty is neither a vice nor a virtue, the novelty here lies not in the court's holding that need must be shown but in the Commission's holding that evidence of need is not required. Indeed, as the *Amerada* record demonstrates (I R. 95-99, 126-27, 1011), all parties including the producers have traditionally recognized that need must either be stipulated or proven, and the Commission's *Hawkins* and *Sinclair* orders mark the first time that the Commission has ever held that a certificate of public convenience and necessity may issue where need is contested and there

is no affirmative evidence to establish a public need for the gas.

4. The producers bitterly attack the *"sua sponte"* nature of the D.C. Circuit's ruling on the conservation issue (Br. 65-66), and they cite a statement made by counsel for the New York Commission at the *Hawkins* pre-trial conference as indicating that the need issue was "narrowly restricted" (Br. 53) and "carefully limited in scope" (Br. 54). We submit that the issue specified by counsel was by no means as limited as the producers would have it; much more important, however, counsel's statement was made as part of an effort to arrive at a stipulation under which part of the need issue might have been disposed of and agreement reached that the balance would be the subject of evidence submitted by the producers. Because of the producers' unwillingness to stipulate, however, and their determination to stand on their legal position that no evidence of public need was required in a producer certificate case (see III R. 64-66), no stipulation was ever reached and the entire need issue was left completely open. If the producers had undertaken their burden of proof on this point and had presented as witnesses officials of the purchasing pipelines to explain their supply and market requirements,[11] it is entirely possible that such testimony would have led into an exploration of the ultimate use of the gas and of the conservation issue generally. The complete failure of the applicants to present any evidence on need, however, effectively foreclosed inquiry into any aspect of need, including the conservation issues.

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[11] It may be noted that in pipeline certificate hearings in which the pipeline is seeking authority to undertake new or additional sales, the pipeline applicant normally presents as witnesses officials of its distribution-company purchasers.

In directing the Commission to expand its horizons and to broaden its considerations in passing upon applications for certificates of public convenience and necessity, the Court of Appeals for the District of Columbia Circuit was applying the regulatory philosophy embraced by the Second Circuit in *Scenic Hudson Preservation Conference* v. *F.P.C.*, 354 F. 2d 608 (1965), *cert. denied*, 384 U.S. 941 (1966), and was anticipating the position adopted by this Court last Term in *Udall* v. *F.P.C.*, 387 U.S. 428 (1967),[12] and by the Third Circuit in *Panhandle Eastern Pipeline Co.* v. *F.P.C.*, No. 16499, Nov. 29, 1967. The Third Circuit described the nature of the Commission's role as follows:

> "Proceedings before the Commission are not private law suits in which a plaintiff wins by default if a defendant fails to appear and defend. On the contrary the public interest is always involved and the Commission, as its guardian, must determine in every proceeding whether the certificate applied for is in the public interest or whether that interest calls for some other disposition. The Commission must see to it that the record is complete and that all relevant facts are before it. Udall v. F.P.C., 1967, 387 U.S. 428." Slip op. p. 5.

The policy established by these decisions has been enthusiastically hailed by the commentators, see, *e.g.*, Reich, *The Law of the Planned Society*, 75 Yale L. J. 1227 at 1248-55 (1966); Comment, *Of Birds, Bees, and the FPC*, 77 Yale L. J. 117 at 126-27 (1967).

[12] See Initial Brief, pp. 25-26.

II. THE IN-LINE PRICE ISSUE

A. The Meaning of "Current Market Conditions"

In its brief to this Court, the Commission defends its reliance on admittedly suspect prices on the ground that "the Commission's essential duty in passing upon the applicant's initial price *is to evaluate market conditions* . . . [in order to fix] a figure that will presumably elicit continuing supplies for the interstate market," and that an "appraisal of current market conditions" requires a reference to suspect prices (FPC Br. 19, 23, emphasis added). To understand the Commission's position it is essential to realize what the Commission means when it speaks of "market conditions" and what factors it means to include when it says it considered "current market conditions".

To begin with, it is clear that the Commission does not mean that it considered the current cost of producing natural gas, either in the abstract or as compared with the cost of producing gas during the period prior to September 1960, when a lower in-line price was found to be appropriate, for there is in fact no evidence of cost in this record, the Commission having ruled such evidence irrelevant to an in-line determination, *Placid Oil Co.*, Op. 398, 30 FPC 283 (1963), *aff'd, United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223 (1965). Further, the Commission does not mean that it considered evidence of the current need of the public for additional volumes of gas, or evidence of the current supply of gas, or evidence of the current relationship between supply and demand, or evidence of the relative needs of, and supplies available for, the interstate and intrastate markets, for again the Commission has ruled such evidence to be irrelevant to an

in-line determination. Finally, and perhaps stemming from the foregoing, the Commission does not mean that it considered whether the in-line price that it set was adequate, inadequate, or more than adequate to bring forth whatever additional supplies, if any, might be needed by the interstate market; notwithstanding the statement of Commission counsel that the Commission was attempting to fix "a figure that would presumably elicit continuing supplies for the interstate market," there is nothing in the Commission's opinion or in the evidentiary record on which that opinion is based which bears on this point.

What the Commission includes in its consideration of "current market conditions" is limited exclusively to the prices being negotiated for proposed new sales and the prices at which the Commission permits proposed new sales to commence under *ex parte* temporary certificates. In its brief to this Court, the Commission does not deny that such prices are "suspect"; nor does it deny that the use of such prices was specifically and repeatedly condemned by four different courts of appeals in the immediate post-*Catco* era on the ground that such prices, being themselves subject to further Commission review, did not constitute a reliable basis for determining an in-line level; nor does it deny that the standard it used in the present cases for determining the in-line level leaves control of the unregulated market price wholly dependent upon the prices allowed by the Commission in unreviewable *ex parte* temporary certificates, which prices are, in turn, fixed solely by reference to the policy guidelines set forth in the Commission's unreviewable Statement of General Policy. What is perhaps most significant of all, the Commission does not contend that the standard

it followed here adequately protects the consumer from the excess prices reached in the unregulated market place.

The Commission's present position thus resurrects the position the FPC originally adopted in 1959, when, in an unsuccessful effort to blunt the effect of this Court's *Catco* decision, it sought to defend its high-priced post-*Catco* certifications on the ground that the various high prices were in line with each other.[13] The several courts of appeals promptly and unanimously reversed, holding that prices which were still subject to further court or Commission review, or were similar to prices still subject to review, could not be used for in-line purposes.[14] On remand, the Commis-

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[13] The Commission's former Solicitor—who had the chief responsibility for defending the Commission's actions in court throughout the 1957-67 period—has recently stated:

> "[I]t is reasonably plain now that on August 10, 1959, . . . it would have saved time and been infinitely better from the point of view of consumers, the pipelines, the Commission, and the producers themselves, if the Commission had then and there heeded the teachings of the Supreme Court's *CATCO* decision. See, e.g., the recapitulation of that story in the Commission's brief in *Pan American Petroleum Corp.* v. *F.P.C.*, CA 10 Nos. 7912 *et al.* (May 16, 1966), pp. 3-5. In the light of that story the Supreme Court's current allotment of 9 hours for argument in the pending 'in-line pricing cases', eight years later, is an eloquent testimonial to the need for objectivity upon the part of the Commission when it has as big a pill to swallow as CATCO." Petition for Rehearing, *International Paper Company*, FPC Docket No. CP68-62, pp. 5-6 n. 5, November 2, 1967.

[14] *United Gas Improvement Co.* v. *F.P.C.*, 283 F. 2d 817 (9th Cir. 1960); *Public Service Commission of New York* v. *F.P.C.*, 287 F. 2d 146 (D.C. Cir. 1960); *United Gas Improvement Co.* v. *F.P.C.*, 287 F. 2d 159 (10th Cir. 1961); *United Gas Improvement Co.* v. *F.P.C.*, 290 F. 2d 133 (5th Cir. 1961); *United Gas Improvement Co.* v. *F.P.C.*, 290 F. 2d 147 (5th Cir. 1961).

sion accepted the courts' admonition and held the line at the pre-*Catco* level, even though this meant ignoring the bulk of gas that was flowing at out-of-line contract or temporarily certificated levels under contemporaneous contracts. This Court affirmed, *United Gas Improvement Co.* v. *Callery Properties, Inc.,* 382 U.S. 223 (1965), expressly noting, 382 U.S. at 227:

> "Consumer protection is afforded by keeping the 'in-line' price at the level where substantial amounts of gas have been certificated to enter the market under other contemporaneous certificates, *no longer subject to judicial review or in any way 'suspect.'* " (Emphasis added.)

Similarly, in two opinions issued after *Amerada* but before *Hawkins* and *Sinclair,* the Commission unanimously held that for the Southern Louisiana sales there involved the in-line price after the September 1960 policy statement continued at precisely the same level it had been prior to 1956, when the *Catco* contracts were executed, *Union Texas Petroleum,* Op. 436, 32 FPC 254; *Superior Oil Co.,* Op. 437, 32 FPC 241. Indeed, the Commission expressly held that "an in-line price, once established, is presumed to continue until substantial evidence is presented that it has changed," 32 FPC at 243. In continuing the prior in-line level, the Commission gave no weight to, but rather regarded as suspect, all contract prices, all temporarily certificated prices, and even those permanently certificated prices at levels above that fixed in the remanded *Catco* proceedings; it did this even though by so doing it totally ignored what it now refers to as "current market conditions". Further, for the crucial offshore Louisiana area, the Commission refused to accord any weight to suspect prices even though there were *no* perma-

nently certificated sales under contracts dated after the policy statement, 32 FPC at 263. For both onshore and offshore areas, the Examiner had found, and the Commission made no contrary finding, that the producers' contract prices were in line with the prevailing market price, but he held this to be legally irrelevant:

> "Our main interest, following the directions of *Catco,* is to halt, rather than follow, the trend of the . . . market." 32 FPC at 300.

We submit that there is no rational basis for applying a different rule to the Texas Gulf Coast area than is applied to the Southern Louisiana area. The Natural Gas Act is national in scope and requires the same high degree of consumer protection for all producer sales.

B. The Claimed Justification for Relying on Suspect Prices

The Commission seeks to justify its reliance on suspect prices on the theory that the court decisions barring the use of suspect prices contain an inherent contradiction. This contradiction arises, according to Commission counsel, because the decisions direct the Commission to keep the in-line price "at the level where substantial amounts of gas have been certificated to enter the market under other contemporaneous certificates, no longer subject to judicial review or in any way 'suspect' ";[15] yet there may be instances where there are no substantial amounts of gas being sold under non-suspect certificates. Under such circumstances, Commission counsel says, to honor the prohibition against considering suspect prices would preclude

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[15] *United Gas Improvement Co.* v. *Callery Properties, Inc.,* 382 U.S. 223 at 227 (1965); see also *United Gas Improvement Co.* v. *F.P.C.,* 283 F. 2d 817 at 824 (9th Cir. 1960).

the Commission from honoring the directive that it consider prices at which substantial amounts of gas have been certificated to enter the market. This conflict—which the Commission purports to resolve by giving suspect prices a "discounted" weight[16]—is wholly contrived.[17] Although Commission counsel relies primarily for his "conflict" theory on language from the Ninth Circuit's 1960 *UGI* decision,[18] the holding in that case was that the Commission could not use suspect prices even where, as was true there, the suspect prices represented the major portion of the gas being sold under contracts contemporaneous with the certificates under review, 283 F. 2d at 824. Moreover, the court was emphatic in holding that prices subject to further Commission review (such as contract prices not yet certificated and prices temporarily certificated) could not be used for in-line purposes, *Ibid.* As the D.C. Circuit, endorsing the Ninth Circuit's standard, subsequently explained:

> "Where the inquiry is whether a particular proposed price is inflated, it serves no purpose to refer

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[16] Although the Commission states that the weight it gives suspect prices is "discounted", there can be no question that that "discounted" weight is decisive. Thus, for example, in its *Sinclair* opinion, the Commission expressly stated (IV R. 4181, emphasis added):

> "In reaching this result [that 16¢ represents the in-line price for the post-policy statement period] we may observe that *if we confined ourselves to permanently certificated sales we would not find a line as high as 16 cents,* for the next highest sales are at the 15.25 cents level."

[17] The Commission was apparently not troubled by any such conflict when it decided *Union Texas,* some five months *after* its *Amerada* opinion here under review. See pp. 17-18, *supra.*

[18] See note 15, *supra.*

> to other prices which may be equally inflated." *Public Service Commission of New York* v. *F.P.C.*, 287 F. 2d 146 at 149 (D.C. Cir. 1960).

Significantly, the Ninth Circuit specifically addressed itself to the possibility that in some situations there might be few, or perhaps no, non-suspect prices that could serve as a reference point for an in-line price; in outlining the standards to be followed in such situations, the court made absolutely no mention of suspect prices, even on a discounted basis:

> "Where there are no producer prices which are otherwise comparable and resort must be had to other criteria, however, relative production costs, need, competition between pipeline companies, and no doubt other factors become significant." 283 F. 2d at 823.

C. The Rationale of the Commission's Elevation of the In-Line Level

In a dazzling display of *post hoc* improvisation, Commission counsel argues (Br. 29-35) that although the evidentiary record in each of the three proceedings—*Amerada, Hawkins,* and *Sinclair*—was radically different, in each there was some reason for giving weight to suspect prices, and that in each instance the effect of giving weight to suspect prices was to elevate the previously determined in-line level for the particular pricing area by exactly 1¢ per Mcf—an amount which, presumably by sheer coincidence, brought the new in-line level into precise accord with the guideline level that had been announced before the respective hearings began. The Commission's present explanations of its actions are entirely inconsistent and unpersuasive. Thus, in *Amerada,* the Commission asserts that it relied on the prices in the contracts then before

it for certification and on temporarily certificated prices because only a small percentage of the gas contracted for between September 1960 and August 1962 had been permanently certificated.[19] But in *Hawkins* and *Sinclair*, where there were admittedly substantial volumes that had been permanently certificated, the Commission nonetheless continued to rely on suspect prices.[20] Moreover, the Commission's *Amerada* reasoning, even assuming that suspect prices may be relied on, is strange: The Commission points to the fact (I R. 5786; Br. 30-31) that the average contract price had risen by 4.1% (from 16.5¢ to 17.17¢) in the period following issuance of the policy statement as the basis for raising the in-line price by 6.7%, a procedure which the Commission asserts (Br. 35) is part of its attempt "to follow this Court's command to aim 'at keeping the general price level relatively constant' ".

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[19] There were, of course, very substantial volumes of gas being sold in District 4 during this 1960-62 period under contracts dated prior to September 1960 at average prices well under the in-line price determined by the Commission. For reasons which are not wholly clear and which are probably not wholly valid, the Commission, in determining in-line prices, has looked not to contemporaneous sales, but to contemporaneous contracts. Although the Commission asserts that it has "taken as its touchstone" the Ninth Circuit's 1960 *UGI* decision (Br. 24), there is in fact nothing in that opinion which suggests that the Commission should, in arriving at an in-line price, ignore the vast majority of present sales that are being made under contracts executed prior to the date of the contracts in question.

[20] Commission counsel's representation (Br. 34-35) that the elevation of the District 3 line to 17¢ can be justified by reference to permanently certificated prices (though the Commission did not purport to do so) overlooks the fact that the three sales permanently certificated at 18¢ were all suspect (III R. 7420-21); if these three sales were excluded, the next highest permanently certificated price was 16.5¢.

The reason for the Commission's result in all three of these cases is a good deal less complex than the Commission's brief to this Court would indicate, and the clue to the factor that actually motivated the Commission may be found in Commissioner Ross's dissent in *Amerada,* in Commissioner Bagge's concurring opinion in *Hawkins-Sinclair,* and in Commissioner Black's dissenting opinion in the same case.

In his *Amerada* dissent, Commissioner Ross accurately portrayed the majority's dilemma (I R. 5797-98, 5804):

> "The majority now is faced with a situation of its own making. Apparently they now recognize that the Policy Statement by itself is not sufficient to raise the in-line price . . . . Thus, it now becomes necessary to dream up some other grounds which, by so doing, raise all kinds of other policy considerations and which in the interests of orderly regulation should be pointed out. It could be that this is substantially a case of 'chickens coming home to roost'. . . .
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> * * *
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> "The majority put itself in a box and closed the top when it inflated a solid in-line price, determined after a hearing, to 16¢ and then remanded those contracts executed after September 28, 1960 for a second hearing. The instant opinion is nothing more than a forced rationalization in support of that earlier position. Obviously, the majority strains to justify a higher price than that decided in *Skelly* and affirmed on appeal. Otherwise, the retrial of those cases would be most embarrassing."

In *Hawkins,* the principal opinion, written by Commissioner O'Connor for himself and Commissioner Swidler, studiously avoided mention of the policy guidelines. Commissioner Bagge, who had just joined the Commission and had not participated in the 1963 re-

vision of the policy guidelines for Districts 2 and 3, concurred in the result, frankly relying on the guideline levels (III R. 7306-07; IV R. 4193). Commissioner Bagge stated that, in his view, it would be desirable if the in-line price could "be made to coincide" with the guideline level, and stated that his determination that the in-line level was 17¢ "recognizes the existence of and takes into account the existing guideline price."

Commissioner Black, with whom Commissioner Ross joined, dissenting, condemned the Commission majority for "affording weight to our guideline policy statement" (III R. 7308), for attempting to support "its predetermined 17¢ level" by reference to the policy guidelines (III R. 7310), and for permitting the in-line determination to be influenced by "our seat of the pants guideline prices" (III R. 7311).

It is highly significant that the Commission majority made no response whatever to these claims of the dissenters, either to point out that the majority opinion did not rely on the policy guidelines or, alternatively, if it did rely on the policy guidelines as the dissenters charged, to articulate and defend that reliance. The reason for this strange hiatus in the majority opinion is readily explicable. The Commission had repeatedly held that the policy statement "did not purport to fix the 'in-line' price," *Amerada Petroleum Corp.,* 29 FPC 171 at 172 (1963); *Union Texas Petroleum,* 29 FPC 273 at 275 (1963); *Union Texas Petroleum,* 29 FPC 733 at 734 (1963), and the reasons that the policy statement could not legally fix the in-line price had been cogently explained by Commissioner O'Connor, the author of the *Amerada* and *Hawkins* opinions:

> "The reason why the Policy Statement cannot effect an automatic approval of proposed rates

> must be clear to you. The Policy Statement was issued without hearing. Parties had no opportunity to contest the 'guide line' prices set forth therein. Section 7(c) of the Natural Gas Act requires notice of an application be given and a hearing be held prior to the issuance of a permanent certificate. It is only after notice has been published that potential protestants and interveners are made aware of the prices proposed to be charged in the event a permanent certificate is issued. Thus, those parties who have valid protests must be heard prior to final action on the certificate application. They cannot legally be denied the right to hearing afforded by statute." Address before Eastern District of America Petroleum Institute, Pittsburgh, Pa., May 3, 1963, mimeo. p. 4 (I R. 5339).

But if, as the Commission has thus recognized, it cannot rely on the guideline levels to determine the in-line level, then it necessarily follows that it cannot rely on prices which have been temporarily certificated, for those prices are based on the guideline levels, and can have no greater force than the source from which they are derived. Indeed, in its 1962 *Skelly* opinion, the Commission had held that temporarily certificated prices were suspect, 28 FPC at 409, and hence not usable for in-line purposes. On appeal, Commission counsel explained (Brief for FPC, *Public Service Commission of New York* v. *F.P.C.,* D.C. Cir. No. 17582 *et al.,* p. 15):

> "Since the price under a temporary authorization is necessarily subject to review in the hearing on the permanent certificate, temporary authorizations are presumptively at prices that must be regarded as under a 'cloud' . . . . Clearly, absent a showing that temporaries are not at out-of-line prices, such untested prices cannot properly be used to justify the issuance of permanent certificates."

Thus, the real issue presented here is whether the Commission can, by promulgating out-of-line policy statement levels—without notice, hearing, or record, and in an unreviewable, *in camera* proceeding—raise the in-line level by thereafter issuing unreviewable *ex parte* temporary certificates at the policy statement levels. We submit that *Catco* bars such action, for, as Judge Bazelon correctly noted in the *Hawkins-Sinclair* appeal, the use of guideline prices to determine temporarily certificated prices and of temporarily certificated prices to determine the in-line levels has led to "an esclation of in-line prices" which "contradicts CATCO's admonition to hold the line" (373 F.2d at 827; IV R. 4309-10).

D. The Role of the Consumer Interests in Commission Proceedings

The producers repeatedly assail the consumer interests for intervening in and contesting producer certificate applications involving proposed high prices (Shell Br. 6-8, 13, 19-26; Sunray Br. 11, 25). They contend that but for such intervention, the Commission would have granted unconditional certification to the producer applicants, without the necessity for lengthy hearings—indeed, without the necessity for any formal hearing at all.[21] In voicing this complaint, the producers clearly reveal that their difficulty is not with the intervenors but rather with the statutory scheme, which

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[21] But *cf. Panhandle Eastern Pipe Line Co.* v. *F.P.C.*, 3rd Cir. No. 16499, Nov. 29, 1967, slip op. p. 5:

> "Panhandle had no right to have its application granted merely because no one had protested or intervened in opposition within the period fixed by the Commission for such action. Proceedings before the Commission are not private law suits in which a plaintiff wins by default if a defendant fails to appear and defend."

procedurally contemplates intervention and hearing, and substantively contemplates that producer price proposals that are not consistent with the public interest will not be certificated.

The producers further contend that, having obtained intervenor status, the consumer interests adopt a wholly arbitrary approach. Thus, the producers allege (Shell Br. 19-20):

> "The Intervenors determined that a price of 14-15 cents was 'acceptable' to them. No plausible reason has ever been given, either in evidence filed in a Commission proceeding or in any brief filed with the appellate courts, for the selection of this level."

Our position has been stated many times in many cases, and several times in this case. We would invite the producers' attention to the record before the Commission (III R. 7123 n. 1), to the extensive discussion in our brief to the D.C. Circuit, pp. 22-25, 29-34, and to our discussion at page 26, note 11 of our initial brief in this Court. Furthermore, we would note that the levels we are urging in this case are not "our" levels but are the levels the Commission had originally set, after hearing, as in-line for the area involved; as we have previously noted (Initial Br. 26 n. 11), the Commission's levels were in excess of the levels we had initially supported.

The producers also suggest (Shell Br. 38 n. 77) that the intervenors have been inconsistent in that the rate recommendation proposed by some members of the consumer-distributor group in the pending Texas Gulf Coast Area Rate Proceeding calls for rate ceilings slightly in excess of the in-line levels found by the Com-

mission here. The producers fail to point out that the rate ceilings they cite are part of an overall package; that they would apply only to gas sold under contracts dated on and after January 1, 1963; and that for gas sold under contracts dated prior to January 1, 1963 (i.e., all of the *Amerada* gas and some 90% of the *Hawkins-Sinclair* gas), the ceiling price is 14¢ per Mcf.

III. THE REFUND ISSUE

Because disposition of the refund issue turns on the nature of a temporary certificate—a point we believe has been well covered in our initial brief and in the Commission's brief[22]—we confine ourselves to three brief points in response to the producer contentions.

1. Temporary certificates, which are exclusively for the private benefit of the producer, are issued at a stage in the proceeding from which potential intervenors—who will be called on to pay for any excess charges—are excluded. If this issue could be neatly divided so that the unfortunate consequences of any dereliction on the part of the Commission would be taxed against the Commission, there might be some grain of logic to the producer position. But here, the producers would tax the Commission's failure to be more specific in notifying recipients of temporary certificates that refunds might be required against parties who were not even permitted to be heard on the whole

[22] Much of the Commission's discussion of temporary certificates (FPC Br. 38-50, and see especially 41-43) demonstrates not only that the Commission was right in holding on the refund issue that permanent rights could not be acquired by virtue of an *ex parte* temporary certificate, but also that the Commission was wrong in holding on the in-line issue that the in-line price could change because of prices temporarily certificated.

matter of temporary certification. As the District of Columbia Circuit recently stated:

> "The premise from which we approach this question is that 'the Commission is not a private party, but a body charged with the protection of the public interest; and it is unthinkable that the public interest should be allowed to suffer as a result of inadvertence or mistake on the part of the Commission or its counsel where this can be avoided.' *P. Lorillard Co.* v. *Federal Trade Commission,* 186 F.2d 52, 55 (4th Cir. 1950)." *Elmo Company, Inc.* v. *F.T.C.,* D.C. Cir. No. 20709, Dec. 27, 1967, slip op. p. 5.

2. The *amicus* brief submitted by Pan American Petroleum, and, in fact, much of the argument made by the producers, represents a distortion of the history of the refund issue. The Tenth Circuit's 1959 *Sunray* decision—*Sunray Mid-Continent Oil Co.* v. *F.P.C.,* 270 F.2d 404—which was briefed and argued at a time when the Commission was defending its unconditional certification of the out-of-line *Catco* prices, hardly has the sweeping consequences now urged by Pan American.[23] The issue of refunds of out-of-line amounts collected under temporary certificates did not become crucial, and there was consequently very little precedent, until the Commission began to make in-line determinations in the early 1960's. As noted in our initial brief (p. 33), the Commission, prior to its August 1962 *Skelly* decision, did *not* follow *Sunray,* but to the contrary did require refunds of excess amounts col-

[23] The Tenth Circuit's decision has never been accepted by the other courts of appeals, but, to the contrary, has been rejected or distinguished both by the Fifth Circuit in April of 1961, *Texaco* v. *F.P.C.,* 290 F.2d 149 at 156-57, and by the D.C. Circuit in January of 1964, *Public Service Commission of New York* v. *F.P.C.,* 329 F. 2d 242 at 250.

lected under temporary certificates. In *Skelly,* the Commission reversed itself and declined to order refunds, and it followed its *Skelly* pattern until January 1964, when the D.C. Circuit reversed the *Skelly* holding. The producers repeatedly cite from Commission orders issued during the erroneous and relatively short-lived *Skelly* period (August 1962 to January 1964) in an effort to demonstrate that the Commission's present policy on refunds is inconsistent with its earlier policy. It is true that the Commission stated many times during that period that it would not require refunds of excess amounts, and it is also true that those statements are inconsistent with the Commission's present rulings that refunds are required. But obviously both the inconsistency and the correctness of the Commission's present position are explained by the D.C. Circuit's reversal of the Commission's no-refund rule in *Skelly.*

3. The producers rely extensively (Sunray Br. 6, 15, 41-42, 44-45, 47, 49, 57-58) on the Commission's February 5, 1963 order (29 FPC 218; I R. 5305) denying intervenors' motion to impose an express condition requiring refund of excess amounts thereafter collected under outstanding temporary certificates, and on the supposed consequences of our failure to petition for review of that order. Although the Commission has correctly analyzed the meaning and consequences of its order (FPC Br. 40-41 n. 28), we believe it may be helpful to note that the motion (I R. 5059-68), made during the pendency of the Commission's *Skelly* no-refund rule, was designed solely to provide partial relief from the harsh results of that rule *in the event Skelly turned out to be valid law* (I R. 5063; see also I R. 79-81). By the time the

Commission ruled on our motion, however, the *Skelly* case was already in the court of appeals, and the successful conclusion of that appeal obviously destroyed not only the basis for the February 5 order, but also the need for the relief denied by that order. In consequence, the appeal from the February 5 order that the producers now insist was indispensable would have been a needless duplication of the broader *Skelly* appeal and would, in all probability, have been subject to dismissal for mootness upon issuance of the *Skelly* mandate.

Respectfully submitted,

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